County of Los Angeles
CHIEF EXECUTIVE OFFICE
Kenneth Hahn Hall of Administration
500 West Temple Street, Room 713, Los Angeles, California 90012
(213) 974-1101
http://ceo.lacounty.gov

WILLIAM T FUJIOKA
Chief Executive Officer

February 14, 2011

To: Mayor Michael D. Antonovich
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe

From: William T Fujioka
Chief Executive Officer

MOTION RELATING TO TAX EXPENDITURES IN THE STATE BUDGET (ITEM NO. 6, AGENDA OF FEBRUARY 15, 2011)

Item No. 6 on the February 15, 2011 Agenda is a motion by Supervisor Ridley-Thomas to instruct the Chief Executive Officer to work with the County's Sacramento advocates to pursue the following positions: 1) broad analysis of the role of tax expenditures in the State Budget and the implications for revenue losses; 2) evaluation of the current tax expenditures that are part of the tax code including a thorough assessment of their respective relevance and appropriateness; and 3) consideration of reduced tax expenditures as a FY 2011-12 State Budget solution and as part of any discussions regarding revenue streams. The focus of this report is on corporation tax expenditures as it relates to the State tax expenditure program.

State Tax Expenditure Program

Existing law requires the California Department of Finance (DOF) to provide a tax expenditure report to the Legislature including a comprehensive list of tax expenditures exceeding $5 million, additional detail on individual categories of tax expenditures, and historical information on the enactment and repeal of tax expenditures. Government Code Section 13305 identifies tax expenditure as a credit, deduction, exclusion, exemption or any other tax benefit as provided for by the State. According to DOF, the four broad classifications of tax expenditures include provisions intended to: 1) conform State tax law to Federal provisions; 2) remove perceived inequities in the basic tax structure; 3) ease tax administration; and 4) grant targeted tax reductions through exemptions, credits, deductions or exclusions.

The Department of Finance indicates that the definition of tax expenditure is subject to interpretation and there is no single rule for defining what constitutes an element of the basic tax structure. The DOF indicates that the State's broad definition of tax expenditures excludes several provisions of the tax law from classification as tax expenditures and its annual report may exclude items that are included in other tax expenditure reports. The DOF notes that revenue losses to local governments for sales tax and property tax do not constitute State tax expenditures. However, the DOF indicates that they impact State finances because local tax exemptions reduce property tax allocations to schools.

According to the Department of Finance Tax Expenditure Report of 2010-11, tax expenditures in the corporation category amount to about $5.0 billion. In FY 2010-11, the DOF estimates that the three largest major identifiable corporation tax expenditures are the research and development credit ($1.4 billion), the water's edge election ($750 million) and the special treatment for economically depressed areas ($630 million). Attached is a table from the DOF report that list major identifiable corporation tax expenditures of $5 million or more. The full report can be found at: http://www.dof.ca.gov/research/documents/Tax_ExpenditureRpt_10-11_web.pdf.

Legislative Analyst's Office

The Legislative Analyst's Office (LAO) indicates that a tax expenditure program is a provision, such as an exemption, exclusion, credit, deduction, deferral, or preferential tax rate, which deviates from the basic tax structure and results in a reduction in government revenues that would otherwise be raised. The LAO indicates that through tax expenditure programs the State provides subsidies to certain groups or individuals in ways that often have not been shown to be cost-effective. The LAO also notes that many tax expenditure programs result in distortions and inequitable treatment among taxpayers.

According to the Legislative Analyst's Office, tax provisions are either statutory or constitutional. Statutory tax provisions can be enacted either by the Legislature directly or by a vote of the people. Typically, statutory tax provisions approved by the voters can be modified only through a subsequent vote of the people. Amending the State Constitution, including establishing or modifying tax provisions, requires voter approval. As with statutory tax provisions adopted by voters, changes to constitutional tax provisions require a vote of the people.

FY 2011-12 State Budget

As reported in the Sacramento Update of January 12, 2011, the Governor's FY 2011-12 Proposed Budget projects a deficit of $8.2 billion in the current year and $17.2 billion in FY 2011-12 for a total deficit of $25.4 billion through June 30, 2012. The Governor proposes to solve the 18-month deficit through a combination of: 1) expenditure reductions ($12.5 billion); 2) extension of tax increases set to expire this year ($12.0 billion); 3) various fund-shifts and borrowing from special funds ($1.9 billion); and 4) establishes a modest reserve ($1.0 billion).

The Governor's Budget proposes to eliminate all Enterprise Zone tax incentives, and similar tax incentives, for specific areas for tax years beginning on or after January 1, 2011. This proposal would eliminate all tax benefits, both for newly earned credits and deductions, as well as for credits that had been earned in prior years, but had not yet been used. The elimination of the Enterprise Zone tax incentives, and similar tax incentives, is estimated to generate additional revenues of $924 million to the State. On February 7, 2011, the LAO's report on California's Enterprise Zone Programs to the Assembly Budget Subcommittee on State Administration recommended that these area programs be eliminated because they are expensive and not shown to be effective. The elimination of Enterprise Zone tax incentives has no direct impact on the County.

The Legislative Analyst's Office *2011-12 Budget California's Fiscal Outlook November 2010 Report* indicates that just as the Legislature will have to prioritize its spending commitments in order to address the ongoing deficit, it also will need to examine State revenues. The LAO suggests that the Legislature should consider several specific revenue policy areas to broaden tax bases such as tax expenditure programs. Modifying or eliminating tax expenditure programs, the LAO indicates, raises revenues without having to increase marginal tax rates.

Because there is no specific Board policy to pursue positions to include: 1) broad analysis of the role of tax expenditures in the State Budget and the implications for revenue losses; 2) evaluation of the current tax expenditures that are part of the tax code including a thorough assessment of their respective relevance and appropriateness; and 3) consideration of reduced tax expenditures as a FY 2011-12 State Budget solution and as part of any discussions regarding revenue streams as it relates to corporation tax expenditures, this is a matter for Board policy determination.

WTF:RA
MR:LY:sb

Attachment

c: Executive Office, Board of Supervisors
County Counsel

Tax Expenditure Report 2010-11

TABLE 2

Major Identifiable Tax Expenditures of $5 Million or More
(Dollars in Millions)

Corporation Tax

Provision	State General Fund Revenue Loss				
	2008-09[a]	2009-10[e]	2010-11[e]	2011-12[e]	2012-13[e]
Research and development credit[1]	$1,155	$1,360	$1,465	$1,265	$1,370
Water's edge election	700	700	750	800	850
Special treatment for economically depressed areas[1]	480	550	630	670	700
Subchapter S corporations[1]	370	370	400	420	440
Double-weighted sales factor	240	250	270	280	300
Like-kind Exchanges[1]	120	100	110	120	130
Corporations exempt from minimum tax	120	120	120	130	130
Accelerated depreciation of research and experimental costs[1]	80	100	120	130	150
Charitable contributions deduction[2]	80	85	90	100	100
Low-income housing credit[1]	50	55	70	80	90
Employee stock ownership plans[1]	44	48	49	46	46
Percentage depletion of mineral and other natural resources	33	36	38	38	38
Credit union treatment	13	12	13	14	15
Expensing of timber growing costs[1]	7	7	7	7	6
Hiring Credit[1]	1	63	290	46	23
Single Sales Factor election	n/a	n/a	280	900	1100
Film credit[1]	n/a	n/a	56	170	120
Total	**$3,493**	**$3,856**	**$4,758**	**$5,216**	**$5,608**

[a]/Actual
[e]/Estimated
[1]/This item includes personal income tax amounts.
[2]/This includes only corporate tax amounts; personal income tax amounts are separately reported.